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Central Intelligence Agency



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DIRECTORATE OF INTELLIGENCE

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CHINA: OFFSHORE OIL DEVELOPMENTS--An Update []

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The Japanese and French exploration projects in the Bohai and the Gulf of Tonkin are continuing with satisfactory speed and with generally good results. China is already pressing its Japanese partners to speed up oilfield development projects which originally were not to begin until after 1985 when extensive exploration was to have been completed. Atlantic Richfield is making good progress on its first exploratory well in the Yinggehai Sea. That well is not scheduled to be completed until the end of May. Beijing is encountering some problems in the South China and Yellow Sea leasing programs, however, and many of the Western firms involved do not expect contracts to be signed until late this summer. Meanwhile considerable activity is taking place with respect to setting up the network of support companies required for a safe and efficient exploration program.

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Bohai: Japanese Activity Picks Up

The Japan China Oil Development Corporation continues to drill successful exploration wells in the Bohai and oilfield development work on fields previously discovered by the Chinese is accelerating. US specialty firms are engaged in some subcontract work for the Japanese but, due to their role in the management of the project, it appears Japanese firms will win the bulk of the development projects, expected to cost in the billions of dollars.

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The key discovery in the Bohai continues to be the first well drilled by the Japanese in mid 1981. Several offset wells drilled into the field, labeled BZ 28 1 by China, in 1982,

This memorandum was prepared by [] the China Division of the Office of East Asian Analysis, for Lionel Olmer, Under Secretary for International Trade. Questions and comments are welcome and may be directed to the author at telephone 351-5868.

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produced good results although not as outstanding as the first well, and it appears the field does warrant commercial exploitation.

[redacted] The Minister of Petroleum, Tang Ke, is [redacted] anxious to get commercial production underway to prove to others in the government the viability of the offshore oil program. The Ministry probably also figures that start up of a development project would boost other Western companies' interest in China.

Exploratory drilling by the Japanese in other possible Bohai oilfields also continues to be remarkably successful. A second well completed in December in the BZ 25-1 field, discovered in 1981, tested at close to 1000 b/d. This is less than the discovery well but encouraging nonetheless. More drilling is needed to determine whether the field is large enough to develop. A well recently drilled into a new structure, BZ 28 2 also discovered oil, bringing to four the number of possible oilfields discovered by the Japanese.

One impact of exploratory success is the need to drill many more appraisal wells than the Japanese had anticipated. This plus higher per-well costs than anticipated have greatly increased the cost estimates for Bohai development.

[redacted] Meanwhile public statements by French company officials indicate that Japan's continued success is encouraging the French who plan to drill several more wells this year after a hiatus in 1982 following disappointments in 1981.

The Japanese are also slowly but steadily moving ahead with development of the Chengbei oilfield--a small field discovered by the Chinese in the mid 1970s in the Bohai and the target of a separate joint venture with Japan. The development process offers some insights into how the much larger scale development envisioned for the new Bohai oilfields and for South China Sea oilfields will proceed.

The Japanese have already installed two "jackets" or superstructures above the field on which the production and support platforms will rest and have begun drilling development wells -- a total of 48 are planned. We estimate production of about 10,000 b/d will begin as early as next year, based on Japanese plans for the field. The jackets, a key item in any offshore development project, were supplied by Japanese steel companies but one was assembled in Tanggu, the Bohai support

base. COPECO, the Chinese Offshore Petroleum Equipment Company which is responsible for providing equipment for offshore projects, recently requested international bids for about \$100 million in production and support modules that will rest on the platforms. As in the case of the broader Bohai joint venture, the Japanese partners are responsible for 49 percent of these development costs while the Japanese Exim Bank is financing the Chinese 51 percent share with a 6.25 percent yen loan. This places Japanese firms in a strong position to win development contracts. [REDACTED]

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[REDACTED] Japan's Exim Bank promised other Western financial authorities that because the terms of its loan for Bohai development were better than that allowed under the existing international consensus agreement for official financing, the loans would not be tied to purchase of Japanese goods as are normal Exim loans. [REDACTED]

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[REDACTED] Although not of particular significance for this relatively small-scale development, the Japanese suppliers probably believe that if non-Japanese firms get a foothold in the Japanese-controlled Bohai project, the Japanese will be in less advantageous position in bidding for South China Sea development projects. [REDACTED]

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Gulf of Tonkin: French Drilling Continues to Meet Mixed Results

Compaigne Franciase des Petroles (Total) joint venture exploration project in the Gulf of Tonkin drilled a disappointing well in its Weizhou 12-3 oilfield in December indicating the field may not be commercially viable, but it may have found a new larger field. A discovery well, Weizhou 10-3-1, tested at about 5,000 b/d in December followed by a second well, Weizhou 10-3-2, which tested in February at over 7,000 b/d, by far its best discovery to date. The joint venture which has already spent over \$100 million has recently been infused with \$50 million in Japanese capital as five Japanese firms including Idemitsu Oil, Indonesia Petroleum, Mitsubishi Petroleum, Taiyo Oil, and Marubeni Trading Company, recently bought a 9.8 percent share. Japan's government-owned oil company, Japan National Oil Company (JNOC), chipped in with a \$35 million loan to the companies. [REDACTED]

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Soon after ARCO began drilling its well, Vietnam reiterated its warning against foreign firms exploring in disputed waters in the Gulf. China responded with a blunt denunciation of Vietnam's claims and warned against any Vietnamese interference. ARCO's well is within Chinese waters by almost any definition, but blocks which China is attempting to lease west of Hainan Island are somewhat debateable.

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South China Sea: Oil Price Decline May Delay Contracts

Beijing is currently in the process of evaluating bids submitted last August from 32 Western firms (originally 33 but Cities Service dropped out after it was acquired by Occidental Petroleum) and is displeased with both the profit share of the oil that the companies requested and the heavy concentration of bids in the best blocks to the exclusion of bids in marginal blocks.

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Since the beginning of the year, CNOOC has invited several of the major contestants to Beijing to iron out these problems. We believe the threat of a major price decline has reduced the firms willingness to compromise on both the profit share and the marginal block issues, however, and is forcing Beijing to reconsider its bargaining position.

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the current oil glut does not radically alter their interest in China. The Pearl River Basin continues to rank very high in their list of possible exploration projects worldwide and short term price reductions may have little or no bearing on the price of oil in the late 1980s when production begins to flow from offshore China. Costs of exploration, moreover, are declining as are interest rates and some expected bottlenecks -- such as drilling rig availability -- have disappeared.

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Beijing continues to register its intent to have US firms take the lead in the South China Sea but there are indications that non-US firms are improving their competitive edge somewhat. British Petroleum and the Japan National Oil Company apparently were the first firms invited to Beijing to discuss the bids in January

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